A REPORT BY THE

TASK FORCE ON FINANCING INFRASTRUCTURE CAPITAL EXPENDITURES

ON THE "SOLUTIONS THROUGH PARTNERSHIP" PROPOSAL

The Municipality of Metropolitan Toronto

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1.0 PREFACE

A private sector consortium operating under the title of "Solutions Through Partnership" has approached the Municipality of Metropolitan Toronto with a proposal to participate in the financing of a major public transit project. The following report prepared by the Task Force on Financing Infrastructure Capital Expenditures (The Infrastructure Task Force) provides a description and analysis of the Solutions Through Partnership proposal. The report also sets out some basic "first principles" to be used in the evaluation of private-public ventures on a more general level and evaluates the Solutions Through Partnership proposal against these principles. Finally, the report puts forward recommendations for future activity.

The Infrastructure Task Force is chaired by the Chief Administrative Officer and is comprised of the heads of the departments of Works, Treasury, Transportation, Planning, Parks and Property, Legal and the Toronto Transit Commission. The Executive Director of Economic Development of the Chairman's Office and the Director of Corporate Planning of the Management Services Department are also members. The review of the Solutions Through Partnership proposal was conducted by the Task Force in its role as the staff group examining alternative financing strategies for major infrastructure projects. The report was prepared for the Task Force by a Technical Committee comprised of senior representatives of Metro Legal, Treasury, Planning, Management Services and the Toronto Transit Commission. Support to the Technical Committee was provided by the consulting firm of Price Waterhouse.

The Task Force heard a presentation of the proposal by a group representing Solutions Through Partnership which was followed by a discussion on questions and issues raised. Two additional meetings of the Solutions Through Partnership group and the Task Force's Technical Committee took place at which detailed financial and planning data concerning the proposal were presented and reviewed. Additional meetings of the Technical Committee took place to further review and analyze the proposal in detail.

The Solutions Through Partnership consortium is comprised of Arendsnest Corporation, Bramalea Limited, Counsel Trust, Olympia and York Developments Limited and Westnor Limited.

2.0 PUBLIC-PRIVATE PARTNERSHIPS

2.1 Preconditions To Public-Private Partnerships

The Solutions Through Partnership proposal presents a strategy to finance a portion of the Sheppard Subway line from Yonge Street to Victoria Park Avenue. It is based on a financing model which envisions the participation of the Municipality of Metropolitan Toronto, the Province of Ontario and a consortium made up of private investors. Somewhat less defined roles for the local municipalities and the federal government are implied.

Although the Solutions Through Partnership proposal is unique in the way that it has configured the various elements of the model, their concept of a private-public partnership is not unique and, in fact, has become a widely accepted approach to financing major public infrastructure in the United States. While it is recognized that the municipal context is very different in the U.S.A., there are many similarities that have forced the municipal sectors on both sides of the border to look beyond conventional financing of some of its major urban infrastructure. Public-private partnerships have proven to be an effective method to do so.

In all cases, regardless of the scale or the nature of the undertaking, there are certain preconditions that must exist to act as the catalyst to bring the public and private sectors together to consider a partnership arrangement. The most basic preconditions include the existence of a problem that neither the public sector nor the private sector could or for some reason would solve independently;a proposed activity that if undertaken would yield mutual benefits to all members of the partnership; and finally, an understanding that all parties are in possession of something that could be brought to the partnership that the other parties wanted or needed.

All three preconditions appear to exist to some extent in the case of the Sheppard Subway. Since June 1986, Metropolitan Toronto has declared its support for a subway line running east - west along Sheppard Avenue linking the North York and Scarborough downtowns. The provincial government has never made this line a top priority and has only committed the funding necessary to extend the Spadina line north from Wilson Station to Sheppard Avenue. In the meantime, while it appears that the Province and Metro have come to an impass on the construction of the Sheppard line, there is every indication that development activities in the North York downtown, an area extending from Highway 401 on the south to Norton Avenue on the north along

Yonge Street, will be delayed pending the provision of significant public transportation capacity for the area.

In addition, although it is not an immediate issue, there are inherent limitations on the development activity along Sheppard Avenue that may only be reconsidered if rapid transit is developed to service the area. Developers in the corridor are predictively interested in seeing the subway built to maximize the development potential of their holdings.

It has never been a consideration that Metro would attempt to independently finance the whole of the Sheppard line. The portion between Yonge and Victoria Park Avenue alone has escalated in cost to an estimated $1,143.8 million in 1989 making the possibility of being the sole funder improbable under existing conditions. The Province has maintained that the Sheppard Subway was too rich a solution and that their own financial limitations prevented them from a commitment to the line.

In combination, the preconditions outlined above exist. First, a mutual problem has been identified for which no immediate or obvious solution exists and from which mutual benefits would be derived if the project was undertaken. Metro Toronto wants the Sheppard Subway built to move people to, through and from the two city centres of North York and Scarborough to act as a catalyst to their development as envisioned in Metro's Official Plan. Representatives of the development industry want the subway built to maximize the potential of their properties. The Solutions Through Partnership group has maintained that its pecuniary interest in the project is separate from any ownership interest that its individual members may have. That may or may not be the case but for the purpose of understanding the impetus and potential for this particular proposal, it must be recognized that various members of the private consortium own properties along Sheppard Avenue and in the North York City Centre and have a very real commitment to seeing the Sheppard line constructed. As a precondition to an effective partnership, that could be a significant benefit.

These things in combination then present an opportunity to look for another partner in the financing strategy. The private sector, which may have a number of legitimate motivations for getting involved, may have access to much needed capital to commit to the project.

2.2 Models of Public-Private Partnerships in Rapid Transit Systems

Due to the capital intensive nature of the construction of rapid transit facilities, a number of innovative forms of financing have been used around the world. In an international context, involvement of the private sector in the design, construction, operation and/or ownership of rapid transit is not unusual. The form and extent of the private sector's involvement in the implementation of rapid transit lines depends on many legal, financial, technological and industrial factors. Consequently, there are a great many configurations that public-private partnerships can take. Generally, however, there are five generic approaches to private sector involvement in the implementation of rapid transit lines.

As shown in Table 1, on page 6, in the conventional model, the role of the private sector is limited to the construction of the rapid transit line under the direction of the public sector. There is no equity contribution and no attempt made to recover the value of the public sector investment from the private sector. In the second model, a private sector contribution is made as an incentive for the construction of a rapid transit line. The private sector recovers its investment through increased value of its land holdings (principally from increased density rights) and/or relief from property taxes. This model does not typically involve "value capture" and has been successfully utilized in London, England for the construction of the London Dockland Light Railway.

In the next two models, some form of land value capture is utilized to recover the cost of the original investment in the rapid transit line. Similar to the Solutions Through Partnership proposal (Model #3), a contribution from the private sector could result in land value capture revenues from a number of alternative sources being retained by private investors. Alternatively, some form of land value capture can also be implemented by the public sector without private sector equity (see Model #4). In fact, this method has been utilized frequently by North American transit systems to build rapid transit facilities. The private sector still benefits in the form of increased densities and increased value of land, however, some portion of the increased value is "taxed back" by the public sector.

In the fifth model, the private sector designs, builds and operates the rapid transit system for a specified period of time (or in perpetuity). Using this approach, the private sector benefits from the increased value of land, increased densities, etc., as well as through the generation of any profit from the operation of the rapid transit line itself.

It should be recognized that there are many "hybrid" versions of the above models. For instance, a private sector equity contribution towards the cost of a rapid transit line (i.e. Model #4) could be justified solely on the increased value of the private sector's land holdings in the corridor. In this example, the public sector (and not private developers) would retain the right to collect land value capture revenues.

TABLE 1

RAPID TRANSIT FINANCING MODELS INCLUDING PUBLIC-PRIVATE PARTNERSHIP MODELS

Element of Rapid Transit System Implementation	NAME OF FUNDING METHOD				
	1. Conventional Model	2. Private Sector Equity	3. Private Sector Equity plus Land Value Capture[1]	4. Conventional Model plus Land Value Capture[1]	5. Build, Operate Transfer[2]
Description of Funding Method	Conventional sharing of costs between local and Provincial/ State/Federal Governments.	Private sector contribution to cost of construction as an incentive for construction of rapid transit line in return for increased density and/or relief from property taxes.	Private sector contribution to capital cost as an incentive for construction of rapid transit line in return for right to collect land value capture revenues.	Conventional sharing of capital costs between local and Provincial/State/Federal Government. Land value capture revenues retained by government.	Private sector builds and operates system for a specified period of time and then transfers ownership to the public sector for a nominal amount.
Examples in Other Jurisdictions	Numerous	Canary Wharf, London Docklands Light Railway	Solutions Through Partnership Proposal (Sheppard Subway)	Los Angeles, San Francisco, Miami, Denver, San Diego	Ankara, Turkey
Who Builds	Transit Operator	Transit operator and/or public-private partnership	Private partnership (Sheppard Subway Partnership) or Public-Private Partnership	Transit Operator	Private Sector
Who Operates	Transit Operator	Transit operator and/or public-private partnership	Transit Operator (T.T.C.)	Transit Operator	Private Sector
Who Pays for Construction	Local and Provincial/State/ Federal Governments	Private sector contribution with remainder by government	Private sector contribution with remainder by government	Local and Provincial/State/ Federal Governments	Private Sector
Who Retains Fare Revenue	Transit Operator	Transit Operator	Transit Operator (T.T.C.)	Transit Operator	Private Sector
Who Provides Operating Subsidy	Local and Provincial/State/ Federal Governments	Local and Provincial/State/ Federal Governments	Local and Provincial/State/ Federal Governments	Local and Provincial/State/ Federal Governments	Private Sector
Land Value Capture	No	No	Yes	Yes	No
Who Retains Land Value Capture Revenue	NA	NA	Private Sector and/or Government	Government	No

(1) Land value capture refers to the practice of recovering part or all of the value of public investment in infrastructure from the private sector (i.e. through development charges, special property tax zones, levies, density charges, etc.)

(2) An alternative to the build, operate, transfer model is where the private sector builds and operates rapid transit in perpetuity (i.e. no transfer to the public sector at a future date).

3.0 DESCRIPTION OF THE SOLUTIONS THROUGH PARTNERSHIP PROPOSAL

3.1 Overview

This section describes the Solutions Through Partnership proposal as it has been presented to the Task Force. An analysis of the proposal is found in Section 4.0.

It has been stated that the proposal came about as a result of a challenge by North York to the private sector to come up with a solution that would see the Sheppard Subway line built. In response, Solutions Through Partnership developed a proposal that is intended to provide an alternative to the public sector to meet the front-end capital financing required to build the Sheppard Subway line. It proposes to build an initial link of the line, from Yonge Street to Victoria Park Avenue, through a private-public "partnership". The partnership would consist of a general partnership of private investors, referred to as the Sheppard Subway Partnership, and the public sector. Under this partnership, the Sheppard Subway Partnership would build and own 100 percent of the system, including rolling stock, and the public sector would lease the system from the Sheppard Subway Partnership at a pre-determined rate, assume full responsibility for all operating costs, and facilitate, if not guarantee, a density revenue stream. Once constructed, Solutions Through Partnership has assumed that the line would be fully integrated with the existing transit system.

The capital costs of the system would be covered by three funding mechanisms: equity contributions from the private sector; sponsorship agreements; and a public mortgage bond issue. A detailed breakdown of each of the funding components is provided in the next sub-section of this report (Section 3.2.). In return for providing an equity contribution, the Sheppard Subway Partnership would be entitled to all or a portion of the revenues generated through the levying of special charges on existing and future development.

In addition to providing a model for the funding of this and other capital-intensive infrastructure projects, it is suggested by Solutions Through Partnership that this specific proposal would provide a number of additional benefits to the public sector. Those include: an opportunity for the provision of 10,000 to 20,000 "affordable" housing units along the corridor through bonusing incentives; improved transit facilities which would ease traffic congestion and environmental impacts; the conservation of the government's debt capacity; and the generation of additional sources of tax revenues for all levels of government.

3.2 Proposed Organizational and Financial Structure

The organizational and financial structure of the proposal is outlined in Exhibit 1 on the following page. As can be seen from this exhibit, the Sheppard Subway Partnership would arrange to finance the total capital costs of $1,071.0 million through a combination of equity, sponsorship agreements and debt as follows:

1. Equity contributions from the partners in the Sheppard Subway Partnership totalling $107.1 million or 10.0 percent of the total capital cost;

2. Sponsorship agreements with retailers, sponsors and advertisers totalling $84.4 million or 8 percent of the total cost; and

3. Mortgage bonds with a value of $880.0 million or 82.0 percent of the total cost.

Equity Contributions:

The five members of the Sheppard Subway Partnership would contribute 10 percent or $107.1 million reportedly upfront during the construction phase of the project thereby reducing the interim financing costs of the project.

Sponsorship Agreements:

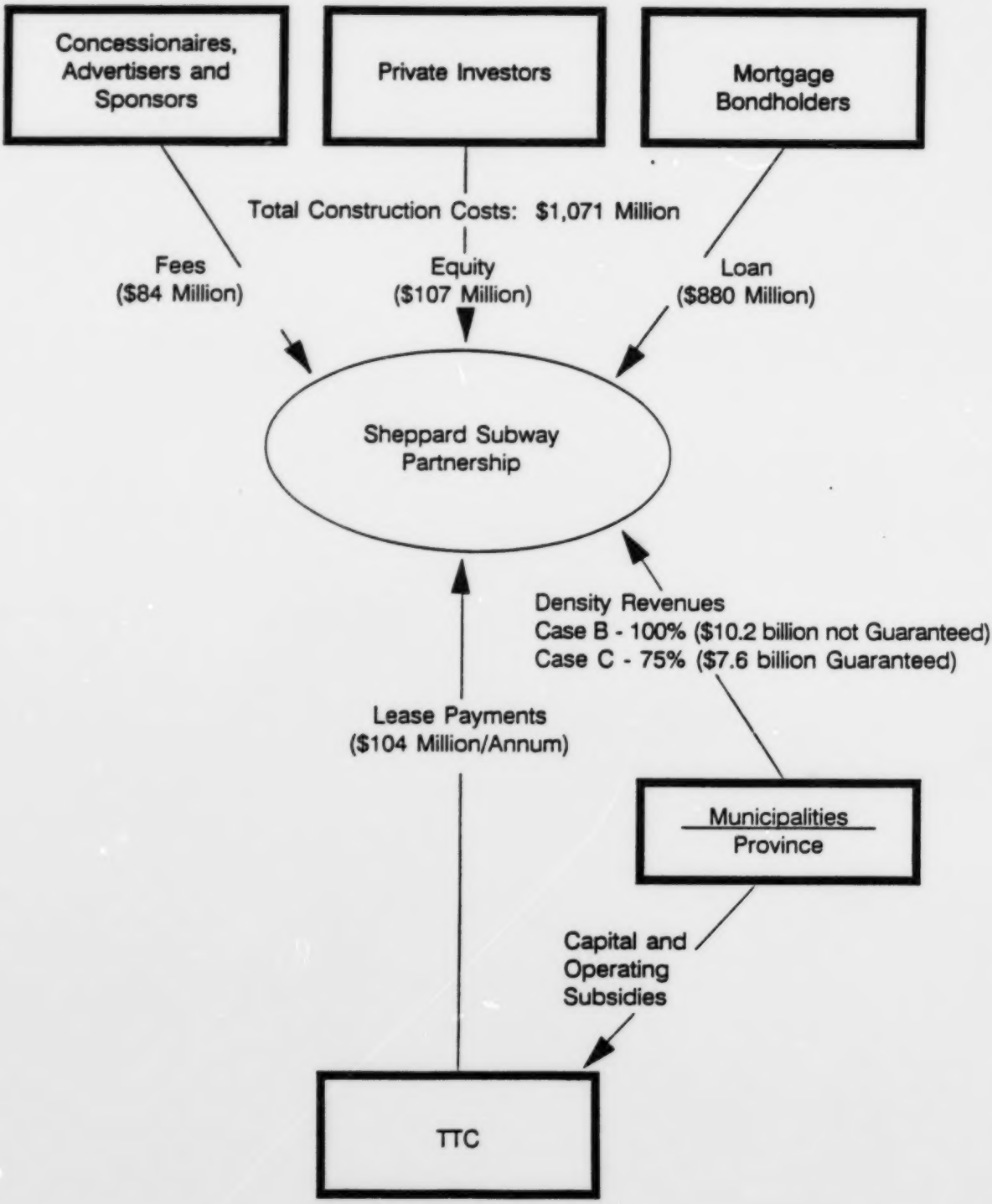
The Sheppard Subway Partnership would enter into sponsorship agreements with retailers, sponsors and advertisers for an indefinite time period. In return for providing an estimated $84.4 million, the sponsors would receive exclusive rights for naming, advertising, promotion and concessions in the six stations proposed in the initial phase of the line.

Mortgage Bonds:

The Sheppard Subway Partnership would arrange the public issue of mortgage bonds. It has been assumed that the bonds would be amortized over 40 years at an annual interest rate of 12.0 percent. The fixed annual lease payment from the Toronto Transit Commission of $104.0 million would flow through the Sheppard Subway Partnership to the bond holders and would fully amortize the bonds over the 40 year period.

EXHIBIT 1

ORGANIZATIONAL AND FINANCIAL STRUCTURE OF PROPOSAL SOLUTIONS THROUGH PARTNERSHIP



The Sheppard Subway Partnership would enter into agreements with the municipalities involved under which they would receive all or a pre-determined percentage of the proposed density revenues generated in the corridor in return for providing equity financing. These revenues would be derived from three different sources: an annual levy on existing commercial developments in the corridor in recognition of increased value to the property; a one time charge on unused residential and commercial density rights up to the existing Official Plan; and a one time charge on increased residential and commercial density rights beyond those currently permitted under the Official Plan as building permits are issued. In the Solutions Through Partnership proposal two cases are presented and compared to an assumed conventional funding model (Case A). In Case B, the Sheppard Subway Partnership would receive 100.0 percent of the annual levy and density revenues but these revenues would not be guaranteed. In Case C, the Sheppard Subway Partnership would be guaranteed 75.0 percent of the annual levy and density revenues with any remainder going to the municipalities involved. A detailed breakdown of the density revenues is provided in section 3.4 of this report.

Under the proposed structure, Metropolitan Toronto and the Province would continue to provide the normal operating and capital subsidies to the Toronto Transit Commission in terms of their relative percentage contribution. In the proposal, Solutions Through Partnership indicates that the annual payment would be approximately 25 percent less than the annual cost that would normally be borne in the conventional model of building and financing such ventures. The effect would be to change the traditional 75/25% Province/Metro split in funding to a 56/19/25% split between the Province, Metro and the Sheppard Subway Partnership.

3.3 Comparison of Conventional and Proposed Financing Models

A summary of the financial data for the assumed conventional funding model (Case A) and proposed financing models (Cases B & C), outlined in the Solutions Through Partnership proposal, is provided in Table 2 on page 12.

As proposed by Solutions Through Partnership and outlined in the table, total hard and soft costs are the same under each scenario. (Hard costs include construction costs, rolling stock and allowances for property acquisition. Soft costs include engineering, administration and construction management.) Compared to the assumed conventional funding model, the interim financing costs, and therefore, the total capital costs, are less under Cases B and C

because of the equity financing provided by the Sheppard Subway Partnership. As a result of this equity financing, the total long term debt and related annual debt payments, are reduced by 23.1 percent. Total density revenues and the present value of these revenues to the investors and the public sector under Cases B and C, are also shown in Table 2.

The return to the investors under Cases B & C, and the impact of different levels of equity participation and density revenues are analyzed in Section 4.1.

3.4 Density Charges and Revenues

The proposed density charges which generate the projected revenues are shown in Table 3, page 13. The density charges for the increased density rights are reported to be based on the estimated average value of land per sq. ft. GFA in the corridor (i.e $50/sq.ft. GFA for commercial and $25/sq.ft. GFA for residential), and 25% of these values for unused existing density rights. It has been assumed that the annual levy and increased density charge would not apply until the first year of subway operation and that the unused density charge would apply the first year of construction. It has also been assumed that the charges would escalate at a rate of five percent per annum.

A detailed breakdown of the projected density revenues is provided in Table 4, page 14. These projections are based on a 50 year time frame and are the same for Cases B and C. The only difference, as mentioned earlier, is that under Case C the municipalities would guarantee payment of 75.0 percent of the total revenues to the Sheppard Subway Partnership with any remainder being turned over to the municipalities.

As can be seen from the table, the annual levy on existing commercial development will generate approximately 20.0 percent of the total estimated revenues. The unused density charge, which would be based on the difference between the density of existing development and the density permitted under the existing Official Plans, would account for 10.0 percent of the total revenues. The final component, the increased density charge, would be based on any densities which are approved beyond those allowed in the existing Official Plans. It would provide approximately 70.0 percent of the total revenues, of which over 94.0 percent would come from increased commercial development.

TABLE 2

COMPARISON OF CONVENTIONAL AND PROPOSED FINANCING SCENARIOS

SOLUTIONS THROUGH PARTNERSHIP

	(Current $ Million)		
	Conventional Model-Case A	**Partnership Model-Case B**	**Partnership Model-Case C**
Hard/Soft Costs	874.9	874.9	874.9
Interim Financing	268.9	196.1	196.1
Total Costs	1,143.8	1,071.0	1,071.0
Equity	-	107.1	107.1
Sponsorships	-	84.4	84.4
Long Term Debt	1,143.8	879.5	879.5
Annual Debt Payment	135.2	104.0	104.0
Reduction in Long Term Debt	-	23.1%	23.1%
Total Density Revenues			
• Investor	-	10,155.7[1]	7,616.8[2]
• Government	-	-	2,538.9
Present Value of Density Revenues @15%			
• Investor	-	368.9	276.7
• Government	-	-	92.2

[1]Case B assumes 100% of revenue to investors - not guaranteed

[2]Case C assumes 75% of revenue to investors - guaranteed

TABLE 3

DENSITY CHARGES

SOLUTIONS THROUGH PARTNERSHIP

	Residential ($/sq. ft. GFA)	Commercial ($/sq. ft. GFA)
Annual Levy on Existing Use	-	1.00
Unused Density Charge*	6.25	12.50
Increased Density Charge*	25.00	50.00

* One time charge

TABLE 4

SUMMARY OF DENSITY REVENUES OVER PROJECT LIFE

SOLUTIONS THROUGH PARTNERSHIP

	Residential sq.ft.(000's)	Revenue ($ Million)	Commercial sq.ft. (000's)	Revenue ($ Million)	Total Revenue ($ Million)	Percentage of Total
Annual Levy on Existing Use	3,337	-	9,455	2,010.78	2,010.78	19.8
Unused Density Charge	9,425	62.88	26,620	954.77	1,017.65	10.0
Increased Density Charge	9,331	416.37	20,180	6,710.93	7,127.30	70.2
TOTAL	22,093	479.25	56,255	9,676.48	10,155.73	100.0

NOTES:

- All unused residential density occupied by 2000
- All increased residential density occupied by 2005
- All unused commercial density absorbed by 2028
- 60% of increased commercial density absorbed over the 50 years

3.5 Planning Assumptions

In developing the projected density revenues, Solutions Through Partnership made a number of assumptions regarding station locations, permissable densities and absorption rates. The proposal assumes that there would be subway stations located at the six nodes of Yonge and Sheppard, Sheppard and Bayview, Sheppard and Leslie, Sheppard and Don Mills, Sheppard and Consumers Road, and Sheppard and Victoria Park.

The total commercial square footage and residential units that currently exist and that are proposed at each node are outlined in Table 5, page 16. The proposal indicates that, with some exceptions, all existing and under construction developments at the Yonge node are at their maximum densities. The background documentation shows that over half of the properties north of Sheppard along Yonge to Norton would be eligible for an increase of 1.5 times coverage which would bring most properties to 6 times coverage and some properties to densities of 7.25, 7.55, 7.21 and 7.99 FSI. South of Sheppard along Yonge, properties that have not reached their maximum densities would increase also by 1.5 bringing most properties to densities between 4.0 and 6.0 and selected properties to densities of 7.0, 7.54, and 10.4 FSI.

Other properties located south of Sheppard and north of Highway 401 between Yonge and Victoria Park would have their allowable densities increased to 3.5 times coverage, while properties located north of Sheppard east of Yonge Street to Victoria Park would have their allowable densities increased to 2.5 times coverage.

The projected absorption rates for residential and commercial development in the corridor, outlined in Table 6, page 17, were, according to Solutions Through Partnership, based on historical trends in the Greater Toronto Area and the expected market share of the corridor in the Greater Toronto Area if the subway were built.

Solutions Through Partnership also assumed that starting in 1996, 75.0 percent of the density absorbed would be in the form of unused existing density rights and 25.0 percent would be in increased density rights and that this would continue until all unused existing density rights were absorbed. Once this happens, all the density absorbed would be in the form of increased density rights.

TABLE 5

EXISTING AND ASSUMED DEVELOPMENT

SOLUTIONS THROUGH PARTNERSHIP

Subway Station/Node	Commercial GFA (000's sq.ft.)				Residential Units[1]			
		Additional[2]						
	Existing	Unused (Per O.P.)	Increased (Beyond O.P.)	Total	Existing	Unused (Per O.P)	Increased (Beyond O.P.)	Total
Yonge and Sheppard	5,561	16,244	7,353	29,158	3,337	4,929	2,910	11,176
Sheppard and Bayview	505	2,557	4,203	7,265	0	4,496	5,140	9,636
Sheppard and Leslie	1,728	3,907	11,669	17,304	0	0	1,281	1,281
Sheppard and Don Mills	784	2,010	4,172	6,966	0	0	0	0
Sheppard and Consumers Road	781	1,845	5,342	7,968	0	0	0	0
Sheppard and Victoria Park	96	57	1,263	1,416	0	0	0	0
	9,455	26,620	34,002	70,077	3,337	9,425	9,331	22,093

[1]Residential unit GFA = 1,000 sq. ft.

[2]Over 90% would be office with the balance retail uses.

TABLE 6

ANNUAL ABSORPTION RATES

SOLUTIONS THROUGH PARTNERSHIP

Time Period	Residential (units)	Commercial (sq.ft. GFA)
1990 - 1995	1000	650,000
1996 - 2039	1500	975,000

4.0 ANALYSIS AND EVALUATION OF THE SOLUTIONS THROUGH PARTNERSHIP PROPOSAL

4.1 Overview

To conduct a comprehensive evaluation of the Solutions Through Partnership proposal requires the examination of many issues in the following broad categories:

- financial
- planning
- legal
- construction and operational
- other

A summary of the major issues in each of these categories is shown in Table 7, page 21. While this list is most likely not exhaustive it covers the main areas of examination that are necessary to come to some conclusion on a proposal of this nature. This section addresses many of these issues but time and the lack of information in certain areas has not permitted a comprehensive examination in each of the categories. Major questions still remain and these would have to be addressed if further progress were to be made on this proposal, or for that matter, on any other proposal of a similar nature.

4.2 Financial Issues

Under Case A, the conventional funding model, Solutions Through Partnership indicates that the total capital costs would be approximately $1,143.8 million which includes $268.9 million in interim financing costs. Under Cases B and C, where upfront financing is provided by the Sheppard Subway Partnership, total capital costs would be reduced to $1,071.0 million because of a reduction of $72.8 million in the interim financing costs from $268.9 million to $196.1 million. Combined with the equity contribution of $107.1 million and the sale of sponsorship and advertisement rights amounting to $84.4 million, Solutions Through Partnership claims that the debt outstanding would be approximately 25.0 percent less than it would be under the traditional funding model. This is shown as follows:

	$ Millions
Long Term Debt: Conventional Model	$ 1,143.8
• reduced financing costs	72.8
• equity contribution	107.1
• sponsorship agreements	84.4
Long Term Debt: Proposed Model	879.5
Reduction in Long Term Debt	264.3
Percent Reduction In Long Term Debt	23.1%

Under its existing financing policies, Metro could provide the upfront capital contribution of $107.1 million and, as a result, realize the net saving in financing costs of $72.8 million. Further, the Toronto Transit Commission could conceivably modify its operating policies in order to generate the revenue resulting from the sale of sponsorship and advertising rights. As a result, the Solutions Through Partnership proposal is, in effect, a proposal by the private sector to provide $107.1 million, or approximately 10.0 percent of the estimated capital cost upfront, in return for over $10.2 billion in potential density revenues (Case B) or alternatively $7.6 billion guaranteed density revenues (Case C). Calculations have indicated that the internal rate of return to the Sheppard Subway Partnership under Case B could be up to approximately 35.0 percent and under Case C, approximately 30.0 percent. These returns are exclusive of any tax benefits or other sources of revenue that the Sheppard Subway Partnership may derive as a result of the project (for example, through the development of property holdings in the corridor). These returns compare very favourably to those expected in today's market. For example, the proposed high speed rail line between Toronto and Quebec City, as reported, will provide an estimated annual return of 12.0 percent over 25 years. It has also been reported that currently the expected rate of return on individual development projects is between 15.0 to 20.0 percent. As a further benchmark, government treasury bills now provide investors a 13.0 percent rate of return.

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In addition, the analysis has shown that the private sector investment of $107.1 million could be paid back in the assumed first year of subway operation i.e. 1996.

The Technical Committee proceeded to determine the impact on the rate of return and years of payback for the project with an increased equity contribution by the Sheppard Subway Parternship. The results of this analysis are shown in Table 8, on page 22. The table shows, for example that if the partnership were to provide equity to the amount of 50.0 percent of the capital costs of the project, the rate of return is still a respectable 15.7 percent. Again, this is exclusive of any tax benefits or capital appreciation of holdings in the corridor. At this level of equity participation, the private sector interests would be paid back by the year 2000 or the fourth year of assumed subway operation. In this case, the increased benefit to the public sector would be a substantial 67.0 percent reduction in the long term debt requirement reducing the annual debt payment from $104.0 million to $44.8 million.

The Technical Committee also analyzed the impact of reduced density revenue on the rate of return for the project at the different levels of equity participation. The results of this analysis are shown in Table 9, page 23.

It can be seen from the table that if revenues were reduced to 25.0 percent of those projected in Case B (either through imposed revenue limits or constrained development activity) the internal rate of return would be 14.9 percent at the 10.0 percent equity level. Alternatively, if the partnership were to increase its equity participation to 50.0 percent and the revenues derived were 75.0 percent of the full amounts projected, the rate of return would be 12.9 percent for the project. Table 9, therefore allows an examination of rates of return for various equity and revenue combinations. It may be possible from a policy perspective to identify a set of equity and revenue combinations that would be acceptable to Metropolitan Toronto (and the Province of Ontario). For example, the shaded area of the table identifies all those equity and revenue combinations that provide rates of return up to a maximum of approximately 13.0 percent.

From a financial perspective, the determination of the acceptability of the project by the public sector would ultimately depend not only on this rate of return analysis but many other factors. These include the already mentioned tax benefits and other sources of revenue that the Sheppard Subway Partnership may derive from the project, the financial risks to the public sector, the extent of guarantees required, the number of years payback, etc.

TABLE 7

ISSUES REQUIRING EXAMINATION

- **Financial**
  - Capital Costs
  - Length of construction and timing of capital expenditures
  - Proposed advertising and density revenues
  - Financial risk to public sector
  - Provincial participation
  - Rates of return
  - Other financial benefits
- **Planning**
  - Consistency of planning assumptions with North York development goals
  - Impact on residential and commercial development in rest of Metro and GTA
  - Impact on other services and infrastructure
  - Provision of affordable housing
  - Sphere of influence
- **Legal**
  - Role of the various members of the partnership
  - Proposed density charges
  - Flowing revenues to private sector
  - Public/private ventures
  - Use of Metro land by private sector at no cost
  - Liabilities
  - Tendering procedure
- **Construction and Operational**
  - Ownership of external subway components
  - Control over developments connecting to the subway
  - Rights to future expansion
  - Ownership of air rights and ancillary bus facilities
  - Responsibility for acquision of additional vehicles
  - Responsibility for major upgrades or modifications
- **Other**
  - Role of the Province
  - Role of the Area Municipalites
  - Clarification of ownership
  - Termination of agreement
  - Public acceptance
  - Alternatives
  - Development industry's ability to absorb density charges

TABLE 8

IMPACT OF INCREASED EQUITY POSITIONS

SOLUTIONS THROUGH PARTNERSHIP

Private Equity (% of total capital)	Private Equity ($ Million)	Total Capital Cost ($ Million)	Long Term Debt ($ Million)[1]	Annual Debt Payment ($ Million)	Reduction in Debt (%)	IRR to Investors[2] (%)	Year of Payback[3]
0	-	1,143.8	1,143.8	135.2	-	-	-
10	107.1	1,071.0	879.5	104.0	23.1	35.2	1996
20	204.6	1,022.8	733.8	86.8	35.8	25.3	1997
35	337.4	963.9	542.1	64.1	52.6	18.9	1999
50	461.3	922.6	376.9	44.8	67.0	15.7	2000
75	665.7	887.6	137.5	16.3	88.0	12.8	2002
100	790.5	874.9	-	-	100.0	11.0	2003

1. Sale of sponsorship and advertising rights assumed to be $84.4 million in all cases with equity participation.

2. Case B density revenues of $10,155.7 million.

3. Assumes project starts in 1990.

TABLE 9

IMPACT OF REDUCED REVENUE PROJECTIONS

SOLUTIONS THROUGH PARTNERSHIP

Equity Amount (% of total Capital)	Amount ($ Millions)	Rate of Return to Investors (%) Percent of Projected Revenues			
		100%	75%	50%	25%
10	107.1	35.2	29.6	23.0	14.9
20	204.6	29.3	20.9	16.0	10.2
35	337.4	18.9	15.5	11.8	7.5
50	461.3	15.7	12.9	9.8	6.1
75	665.7	12.8	10.5	7.9	4.6
100	790.5	11.0	8.9	6.6	3.6

In conclusion, the proposal, could augment the funding for the construction of the Sheppard Subway line and since the Province has not committed to provide any funding of this line, it may well be an very important consideration if Metro wants to proceed.

It is clear that depending on the amount of equity that is provided, participation by the private sector in the financing of the line could significantly reduce the total debt load of the public sector, and as a result, release resources to meet other community needs.

Under the proposed 10.0 percent equity scenario, which this proposal represents, the return to the Sheppard Subway Partnership could be substantial. As such, this proposal, as currently structured, does not represent a good financial deal for Metro since it could be foregoing some $10.2 billion in development revenues for an initial equity contribution of $107.1 million which it could raise itself under existing policies. If Metro were to proceed further with this concept, a higher level of equity contribution from the private sector as well as constraints on the revenue returned would be a minimum financial requirement in order to bring the projected rate of return more in line with current market conditions and afford the public sector the opportunity to utilize development revenues for its own needs.

No analysis has been conducted on the potential tax revenues that would be generated as a result of the development that may occur if the Sheppard Subway line were built but it is clear that these would accrue to all levels of government regardless of who provided the upfront financing if the suggested uses and densities were achieved.

And finally, this proposal represents one possibility for financing the construction of the Sheppard line. There are, as was mentioned earlier in the report, a number of alternatives within the proposal framework which could be further pursued. The benefit of this particular proposal is that it provides Metro with an opportunity to fully explore the applicability of an equity-driven financing framework.

4.3 Planning Issues

Accepting the Solutions Through Partnership assumptions regarding growth in commercial development, the resultant total office space in the corridor would represent about two thirds of the existing office space in the City of Toronto downtown. This level of development growth represents about 20.0 percent of all office space growth in Metro over the planning horizon. This 20.0 percent figure is a very optimistic allocation and is considered to be the maximum that could be expected under ideal conditions.

The Solutions Through Partnership proposal also suggests that the opportunity to provide up to 20,000 units, or 20,000,000 sq. ft. of affordable housing could be provided. This represents 100 percent of the assumed growth in residential units in the proposed area. It is considered more realistic to assume that some 25.0 to 50.0 percent of total residential development could be affordable. However, because there may be a need to have a greater proportion of residential development in the corridor, the absolute figure suggested by Solutions Through Partnership may be realistic.

The question has also been raised as to the capability of the existing infrastructure, other than transit, (i.e. sewer, water and roads) to accommodate the projected commercial development. With regard to the Solutions Through Partnership proposal, it may be more appropriate to have a better balance between growth in residential and commercial development. However, it should also be mentioned that the question of infrastructure needs to be addressed if the subway is to be developed and if the density of that development is to exceed that which currently exists regardless of whether the Solutions Through Partnership, or any other private sector group, is involved in the financing of line.

An important planning issue that cannot go unaddressed relates to the public's acceptance of the levels of development assumed by Solutions Through Partnership. To achieve the density levels, amendments to the North York and Scarborough Official Plans would be required. These official plan amendments would be subject to review by the public and, in the event of appeals, would be referred to the Ontario Municipal Board for resolution. This process cannot be circumvented and could take a number of years depending on the scale of any public opposition. Furthermore, the outcome of such a process cannot be guaranteed. In view of the key role the local municipalities must play in this process, North York and Scarborough should be partners in any innovative funding proposal.

4.4 Legal Issues

Although a significant number of legal issues arise out of the Solutions Through Partnership proposal, none is addressed within the proposal. The Infrastructure Task Force has not attempted to conduct a comprehensive review of the issues at this time, but has raised, for consideration, those that are fundamental to the proposal.

Under the proposal, the line would be constructed and owned by the Sheppard Subway Partnership and operated by the Toronto Transit Commission under a long-term net lease. For the purposes of this discussion, it is assumed that most of the line would be constructed within the Sheppard Avenue road allowance (a Metro road) but that some portions of the line, especially for station requirements, would be outside the road allowance. This requirement raises a number of legal concerns respecting the placement of the subway under Sheppard Avenue, the acquisition of lands by Metro and the transfer of lands or interests in land to the Sheppard Subway Partnership and the exemption of such lands from property tax or a grant in lieu. However, the serious and most immediate legal issue would be the authority to establish the sources of revenue flowing to the Sheppard Subway Partnership, apart from the annual rental to be paid by the Toronto Transit Commission, in the form of the density charges proposed by Solutions Through Partnership.

In review, the proposal envisions three charges to be levied against existing and future development in a corridor that runs east from Yonge Street to Victoria Park both north and south of Sheppard Avenue and on properties in the corridor running from Highway 401 on the south to Norton Avenue on the north on both the east and west sides of Yonge Street but not necessarily fronting on Yonge Street. The proposed first charge is an annual levy on existing commercial developments in the previously described area. The proposal states that this charge would be applied in recognition of increased value to the property, presumeably because the subway line had been developed. A proposed charge of $1.00 per square foot is suggested. A second type of charge, a density charge would be imposed for unused existing commercial and residential "density rights" under the existing Official Plan which would be paid at the time of the issue of the building permit. The third charge would be imposed for commercial and residential "density rights" beyond those currently permitted under the existing Official Plan, again to be collected at the time of the issue of the building permit. It must be made clear from the outset that these are not "development charges" with which Ontario municipalities are familiar and that are the subject of Bill 20: The Development Charges Act, 1989.

In terms of the proposed annual levy of $1.00 per square foot on existing commercial developments, it is suggested that the application of such a levy is somewhat arbitrary in that it is not "growth-related" nor does it bear any relationship to the cost of the construction or operation of the line. The fact that the proposal states that these would be imposed "in recognition of increased value to the property" suggests that their origins may lie in the theoretical base of land-value capture. The thinking being that there is a quantifiable, and therefore recoverable, escalation of land and property values with the addition of a public utility, in this case the subway. There would appear to be no legislative precedent for this type of levy or charge with the exception of the Commercial Concentration Tax Act through which, as of January 1, 1990 within the Greater Toronto Area, the Province imposed an annual tax of $1.00 per square foot on all commercial parking lots and on all commercial buildings to the extent that the area of such buildings exceeds 200,000 square feet. Without going into detail, the Province justified this new charge by stating that the "provision of public infrastructure frequently results in substantial benefits to specific groups" and includes within those benefits to commercial property owners capital gains from lands and building value increases. They further state that "those who benefit significantly and directly from the provision of new infrastructure should be required to make a greater contribution to the costs of that infrastructure".

In the case of the second and third one-time development and density charges, there is no existing legislative authority for municipalities to impose the suggested charges but there is authority to impose "growth-related" charges or to require benefits in exchange for the granting of additional development rights. These authorities are found in the previously mentioned Development Charges Act, 1989 (Bill 20) and section 36 (Increase in Height and Density) of the Planning Act, 1983.

The Development Charges Act, 1989 (Bill 20) authorizes municipalities, including regional, metropolitan and district municipalities, to pass by-laws to impose development charges against land if the development of the land would increase the need for services. The purpose of the Act is to enable municipalities to recover from developers the "growth-related net capital cost" (or a portion thereof) of services directly attributable to the need for such services resulting from development in all or a defined area of the municipality. The definitions in the Act are broad enough to cover all physical transit facilities including rolling stock. These charges, however, differ from those outlined in the proposal in that

they are directly tied to the capital cost of a specific public project, where those suggested in the proposal are not.

It should be noted that any charge which focuses on the development of property within a defined area must be reasonable in terms of the choice of boundaries for the area and in terms of the means of levy. The Solutions Through Partnership proposal focuses on development within a defined corridor, but does not limit itself to the cost of development of the subway. Owners within the corridor may argue that the charge is inequitable on the basis that owners outside the corridor benefit from the subway but are not required to contribute to the costs. Furthermore, owners might argue that the levy rates are too high in that they provide for a sum greater than the total costs of constructing the subway. A development charge, made pursuant to the Development Charges Act, must be geared to the recovery of the infrastructure investment over a reasonable period of time, from a source which causes the need for the infrastructure.

In terms of the third charge, it most closely resembles a "density bonus". Section 36 of the Planning Act permits a local municipality in a zoning by-law to authorize increases in the height and density of development otherwise permitted by the by-law in return for the provision "of such facilities, services or matters" as are set out in the by-law. It is a requirement for the inclusion of such a provision in the by-law that there be an official plan in effect that contains provisions relating to the authorization of increases. The section also provides that where an owner elects to provide such facilities, services or matters in return for such increases, the municipality may require the owner to enter into an agreement which, once registered against the land, may be enforced against the owner and all successors in title.

While Metro does have the authority to pass zoning by-laws with respect to lands lying within 45 metres of Metro roads, it does not have the authority conferred upon local municipalities by section 36 of the Act. Furthermore, there is nothing in the section which specifically authorizes an area municipality to obtain or secure a benefit on behalf of Metro.

Use of section 36 requires agreement between the developer and the area municipality. In that sense, it is not something that the municipality can "impose". Further, the expression "such facilities, services or matters" is not defined. This authority has been used to obtain a variety of perceived benefits such as the preservation of historical buildings and the provision of assisted housing including land distant from the development site for such purposes.

In conclusion it is suggested that there is no existing legislative authority that would enable the Province, Metro or the local municipalities to levy the charges proposed in the Solutions Through Partnership proposal. While there are precedents for elements of the charges, the proposal cannot be implemented under existing legislation. The most appropriate remedy would appear to be the enactment of special legislation that would establish the type of charges and amount of the charges to be levied.

The special legislation would detail the rights and obligations of the various parties which would serve to clarify issues such as: the ability of Metro to impose or obtain a benefit under Section 36; the roles the various parties are to play in terms of the collection of the revenues and cash-flow; trust obligations; general funding considerations; the identification of the "benefitting area"; the relationship between the charges imposed for the construction of the Sheppard Subway and other levies or charges imposed by Metro, or North York, or other authorized bodies; the appeal rights against the quantum or application of any levies imposed; and any other special legislative authority which might be required, such as the right to expropriate land for stations and convey such land to the partnership; or exempting from property tax a subway facility not owned by Metro or the Toronto Transit Commission; or the basic authority for the municipalities involved to enter into agreements securing the relative rights and obligations of the parties.

Even assuming the intended charges were legal and collectible, the proposal has not set out the precise mechanism for the flow of revenues into the hands of Sheppard Subway Partnership. A trust of some kind is envisioned. However, it is impossible at this stage to comment on a form which would be acceptable to all parties involved.

One final point is that it appears the powers and duties of the Toronto Transit Commission, as set out in the Municipality of Metropolitan Toronto Act, would be broad enough to permit them to enter into agreements providing for the lease of a subway system and the payment of rent in respect thereof. Under a net lease, the Toronto Transit Commission would pay all costs of operating the subway line, including maintenance, insurance, taxes and other operating costs.

4.5 Construction and Operational Issues

Although it is recognized that the proposal has been developed on a conceptual level and that the detail would evolve over time, there are significant construction and operational issues that the Toronto Transit Commission has raised for consideration. In many cases, these issues highlight the significant departure from current Toronto Transit Commission policies and practices that the proposal envisions.

Perhaps the most contentious of these is the assumption that the Sheppard Subway Partnership would assume responsibility for the advertising, sponsorship and retail leasing in the proposed stations. The Toronto Transit Commission currently has policies for the naming of stations and its own advertising standards which would currently preclude the type of sponsorship envisioned. As well, the Toronto Transit Commission has traditionally generated these types of revenues to offset the operating cost of the line. Presumably, these revenue sources would not be available to the Toronto Transit Commission from the Sheppard Subway line.

Similarly, the issue of large scale retail leasing in the paid area of the subway is a contentious issue that was addressed in the Toronto Transit Commission's Back to Basics report. The scale of retail leasing envisioned in the Sheppard Subway Partnership proposal would be unprecedented in the subway system and despite the revenues involved could be unacceptable to the Toronto Transit Commission. As well, the Toronto Transit Commission traditionally has not specifically designed stations to permit retail leasing. To incorporate the level of retail leasing envisioned in the Solutions Through Partnership proposal, Sheppard Subway stations would have to be larger than typical Toronto Transit Commission designs. To do so could involve considerable additional capital expenditures and it should be noted that these costs would be over and above those set out in the Solutions Through Partnership proposal.

The overall design standards for the line including vehicles and the compatibility of the Sheppard Subway line with the rest of the subway system is an issue. Since the Toronto Transit Commission would be responsible for maintaining the line, it would want to ensure that its design standards were strictly adhered to. This is an important consideration since Toronto Transit Commission riders would ultimately be assuming a significant share (68 percent) of on-going maintenance costs. The mechanism for ensuring Toronto Transit Commission design standards are respected is unclear in the Solutions Through Partnership proposal.

In terms of the construction schedule, it is believed that the proposed time frame is optimistic. A seven or eight year construction schedule rather than the six years as outlined in the Solutions Through Partnership proposal, is more realistic especially in light of the various approvals needed for this line (Environmental Assessment Board, Ontario Municipal Board, Ministry of Transportation of Ontario) and the numerous legal, financial and operational issues that would have to be resolved before construction could begin. This could have a significant impact on the interim financing costs outlined in the proposal.

On a related matter, the relationship between the Sheppard Subway Partnership and the Toronto Transit Commission is unclear particularly in terms of who is responsible for the design and construction of the subway, the design and procurement of rolling stock and the purchase of land. The Toronto Transit Commission would want to retain control over the design and construction of the line including final approval at various stages of construction, the awarding of construction contracts and the procurement of rolling stock.

It should be noted also that Solutions Through Partnership maintains in its proposal that the capital cost estimates of the development of the Sheppard line are Toronto Transit Commission estimates from October 16, 1989. No such estimates have been generated by the Commission and it appears that these figures may have been derived by Solutions Through Partnership by inflating August 1987 figures found in a report entitled "Sheppard Subway Functional Planning Review". The Toronto Transit Commission has not up-dated these figures and therefore cannot verify the $874.9 million cost estimate provided in the proposal.

Finally, the Toronto Transit Commission would need to maintain full control over the operation of the line including hours of operation, fares, level of service, attendants at entrances, etc. These issues were not specifically addressed in the Sheppard Subway Partnership proposal and would certainly need to be addressed in the early stages of any future discussions.

Other items that would need to be addressed if Metro was interested in pursuing this type of arrangement with a private consortium are included in Table 7, Issues Requiring Examination, on page 21.

4.6 Other Issues

Beyond the financial, planning, legal and operational issues are a number of issues that would need to be studied in more detail if Metropolitan Toronto Council wanted to further pursue the Solutions Through Partnership proposal or other public-private partnerships solutions to the development of the Sheppard line. Most notably would be the clarification of roles that the Provincial government and the local municipalities would play. No formal discussions to date have taken place with any of these parties but it goes without saying that the project could not proceed without the support and partnership of at least the appropriate local municipalities. A process for their early involvement would need to be established.

There are also issues that may need to be addressed as plans for the Sheppard Subway proceed regardless of the financing strategy used. These include a detailed review of the acceptable densities that would be permitted along Sheppard Avenue; the nature, cost, and limitations of additional infrastructure required to service the increased densities; and the impact of the projected densities and uses on the development in other parts of Metropolitan Toronto.

One final comment relating specifically to the Solutions Through Partnership model involves the annual levy and density charges envisioned in the proposal. The Task Force did not undertake a review of the development industry's ability to absorb the proposed charges or to assess the impact on development activity if the charges were imposed. Such studies would most likely need to be conducted if charges were to be imposed on the development industry to pay for the line.

5.0 A GENERAL BASIS FOR EVALUATING PUBLIC-PRIVATE PARTNERSHIP PROPOSALS

5.1 Consideration of "First Principles" for Public-Private Partnerships

The evaluation activity undertaken by the Task Force responded directly to the Solutions Through Partnership proposal. As such, the Task Force had to establish a basis from which to conduct the review. It made, strictly for the purpose of the review, three primary assumptions. First, that the Sheppard Subway continued to be Metro's first transit priority and that the portion between Yonge Street and Victoria Park Avenue would be the first stage to be developed after the Wilson to Sheppard extension of the Spadina line. Second, that Metro and the Province would be participating partners in the financing of the project. Although as the review progressed, the certainty related to this assumption became increasingly tenuous. Third, that both Metro and the Province of Ontario would accept, if not welcome, private sector involvement.

As basic as these assumptions were, they were necessary to provide a stable basis for the analysis. Throughout the process however, it became obvious that a policy void existed, one that provided the most basic of tests against which to assess this or any other public-private partnership proposal. What was seen to be missing was a set of guiding principles that reflected Metro Council's position on the participation of the private sector in the provision of public infrastructure and parameters that would be placed on that participation. As the discussion and evaluation took place, certain basic principles started to emerge that were considered to be the foundation upon which Metropolitan Toronto could build if it were to proceed in partnership with the private sector in the funding of capital infrastructure. These became known as the "First Principles". These "First Principles" if endorsed by Metropolitan Council, could provide the basis for the evaluation of subsequent proposals.

The Task Force has developed the following six "First Principles" for Council's consideration:

1. That Metro Toronto acknowledge the potential role for the private sector in the provision of major public infrastructure.

2. (a) That the opportunity to participate in any public-private venture contemplated by Metropolitan Toronto be open to all interested parties.

Interest is to be demonstrated by way of a response to a public call for concept proposals.

(b) In the case that a proposal has been submitted on speculation and the suggested project is determined to have merit, that a public proposal call be undertaken unless it can reasonably be determined that no other party would be interested in participating.

3. (a) That in general the public sector's responsibility for operating public facilities be assumed by the private sector only in the case that the existing standard or a higher standard of service can be guaranteed.

(b) That the operation of the subway system remain the responsibility of the public sector with private sector involvement in operations contemplated only in the case of augmented services.

4. That no proposal be considered that is predicated upon the public sector's disregard or abandonment of due process in determining community goals.

5. (a) That there be complete disclosure of all information that relates to the private sector participants and their interests in the venture.

(b) That the benefits that would accrue either directly or indirectly to the participating private sector members be evaluated on an individual and collective basis.

6. (a) That the return to the private sector participants be in direct relation to the degree of participation and risk that the public sector expects the private sector to take and that the return is fair and publicly defensible.

(b) That the public sector's indebtedness to the private sector not be tied to any type of commitment that provides the private sector exclusive access, either directly or indirectly, to a significant municipal own-source revenue.

(c) That a public sector benefits/cost evaluation be conducted respecting any project involving a partnership with the private sector.

These "First Principles" start to give some form to the structure that a private-public model would have to take to be acceptable to Metro Council and to the public at this point in time.

5.2 Review of the Solutions Through Partnership Proposal Based on the "First Principles"

The Solutions Through Partnership group has taken the risk of committing significant financial resources to the development of a model that includes, as a partner, the private sector in a traditional public activity – financing a public rapid transit system. The proposal is unique in that it is an entirely untested area in the Metro context. It has provided a wealth of food for thought and has acted as a catalyst for the Task Force to contemplate the appropriate roles for the private sector. It has also offered a glimmer of hope that with the right "deal", a public-private joint venture could, in fact, be the solution to getting the Sheppard Subway constructed.

Section 4.0 analyzed the proposal from a financial, planning, legal, and operational perspective. The evaluation that follows draws upon that analysis but places it in the context of the "First Principles" to give some insights into some of the modifications that would be necessary to mould the Solutions Through Partnership proposal into a more workable arrangement.

Principle 1: Role for the Private Sector

There is a natural hesitancy for the public sector to undertake large projects with the private sector based on the general attitude that the public sector usually comes out with the short end of the stick in any such venture. This attitude may be even more prevalent when it comes to activities that specifically involve the development industry. Public representatives are quick to cite examples, where in fact, their dealings with private interests have been less than satisfactory. At the very heart of the matter is the public sector's inexperience in dealing with the private sector in activities that involve an entirely different set of rules with which they are familiar. The scepticism and the hesitancy are entirely understandable. This may not, however, be a reasonable basis upon which to reject private sector involvement in future activities, especially when it can be proven that it can result in mutual and somewhat equivalent benefits for all.

On the other hand, the private sector does not always understand nor is it sensitive to the intricacies of doing business in the open and democratic processes of the public sector. Therefore, it must be recognized that, the public sector and the private sector are not operating on the same playing fields and that a successful partnership is only likely to occur if they are. The expertise required is often accessible through consultants who can work with both sectors

in developing the common understanding necessary to proceed. For Metro's part, it may be necessary in the immediate future to retain the appropriate expertise to complement the in-house skills to ensure that Metro's interests are being protected in the case that Metro Council wants to pursue a partnership with the private sector on a project of this magnitude. Council may also want to consider, if it selects to pursue a partnership arrangement, to work with an independent third party who would develop the terms of the partnership with both parties.

By adopting a position that there is a role for the private sector, Metro Council will be conveying the message that there are opportunities for the private sector to assist in solving "public" problems. The Solutions Through Partnership proposal is one example of the private sector's willingness to work with the public sector in doing so.

Principle 2: Access to Private Sector Participation

Although the Solutions Through Partnership group was the first group that formalized its interest in working on a Sheppard Subway financing strategy, there is some uncertainty whether their consortium would be the only group interested in pursuing a joint-venture. The consortium maintains that it should be seen as a group of investors rather than a group representing the interests of a significant block of developers in the benefitting area. Given that, and if there can be significant incentives to investors who have no interest in the resultant development activities, then there may in fact be other groups of investors with other financing strategies that would want the opportunity to make a proposal. Metro Council may want to consider other suggestions or strategies by conducting some type of proposal call. If, on the other hand, Metro Council can be reasonably assured that because, as developers along the Yonge Street and Sheppard Avenue corridors, the Solutions Through Partnership group represents the only interested party because of its obvious commitment to getting the Sheppard Subway built, then it may want to continue to work with this group to develop a more acceptable proposal.

Principle 3: The Operation of Public Facilities

The Task Force could envision a number of publicly delivered services that could be operated by the private sector. However, in the case of public transportation it was believed that this would not be acceptable at this time under any arrangement. For that reason, the Build, Operate and Transfer model of public-private partnerships described in Section 2.2 would not be an acceptable

model under current conditions. It was conceivable, however, that certain augmented services or secondary services currently provided by or through the Toronto Transit Commission could, under the right circumstances, be assumed by the private sector.

The Solutions Through Partnership proposal does not suggest that it would operate the trains. It does however, assume certain operational responsibilities in its assumption that it would lease space, sell sponsorships and sell advertising rights. These are currently the responsibilities of the Toronto Transit Commission. While it is recognized that what the proposal envisions is not comparable to the existing practices of the Toronto Transit Commission, it has been assumed by the Task Force that the same opportunities to maximize these activities would also be open to the public sector. Regardless, in an effort to define some potential areas for private sector involvement, this was considered to be an area for consideration and as such, the Solutions Through Partnership proposal is not inconsistent with the Task Force's thinking in this area.

Principle 4: Due Process in Determining Community Goals

The proposed returns to the Sheppard Subway Partnership are directly tied to the amount of commercial and residential activity that takes place in the Sheppard Corridor and along Yonge Street through the density charges that would be levied against the development activity. Obviously then, under both Case B where 100% of these revenues flow to the private sector and Case C where 75% flow to the private sector, the rate of return to the private investor increases in direct proportion to the amount of development activity permitted. The proposal has made certain assumptions about the demand for residential and commercial space in North York and to fulfil that demand, makes certain assumptions about the densities that would be required to permit the development of the residential and commercial units. The North York Planning Department has indicated that pending further study on this matter, they are not in a position to say whether the suggested densities are in excess of that which they would envision over the long term with the existence of a subway. Although the Solutions Through Partnership group has made a number of statements respecting the sanctity of the planning process and the municipality's right to determine the scale of density that is compatible with its community goals, it could be anticipated that when it got down to negotiations, there would be a requirement for some guarantees on future densities over and above those currently permitted to provide a measure for the investors to determine their potential return.

This principle is included to highlight the fact that the private sector's involvement in any public activity should not influence sound municipal policies and practices. That in an attempt to strike an agreeable arrangement, that public responsibilities not be neglected. Although it would be unrealistic to assume that all practices would be free from influence, it is suggested that any substantive public responsibility must be protected. It is the responsibility of the public sector to ensure that the appropriate controls are in place to do so.

Principle 5: Disclosure of Information

The rules for conducting business in the public sector may, at least on the surface, appear to be somewhat different than those employed by the private sector in regard to the disclosure of information. It is not only an expectation but a requirement that everything be on the table when dealing with the public sector. This does not imply that sensitive information would be released to the greater public, but that whatever information is required for the public sector to ascertain the full range of implications of participating in the partnership be made available. As a standard practice, the public sector would need to know not only the explicit or declared benefits that would flow to the private sector participants, but would also need to assess the value of the more implicit benefits such as those with tax implications, possible benefits derived through land value escalations, and so on. In addition, it would be a requirement to disclose all sources of finance and all participants in the case of a private sector consortium. The timing of the required disclosures would be commensurate with the stage in the process or negotiations.

With the exception of one request, the Solutions Through Partnership group has been forthcoming with requested information. Recognizing that many details of their proposal would be firmed up only if Metro made some commitment to pursue this venture, the Task Force has attempted to request information that it could be reasonably assured would have been prepared previously or that would not entail a great amount of work to assemble. The one exception relates to the financial and tax benefits that would accrue to the five participants in the consortium. Only in the case that Metro Council indicated an interest in pursuing the proposal would the Task Force make an additional request for this information.

Principle 6: Return to Investors and Source of Repayment

Section 4.0 reviewed the financial aspects of the proposal and highlighted the significant details. The private sector would contribute $107 million as a 10% equity investment. For their contribution, they would receive all or 75% of the revenues that would be generated through the annual levy and density charges over the 50 year term of the agreement, a figure that was projected to amount to $10.2 billion under Case B or $7.6 billion under Case C. The private sector would also arrange for the issuance of mortgage bonds to the general public totalling $880.0 million at a rate of 12% over a 40 period, a rate that most probably would be available only by virtue of the fact that the loan was guaranteed by the public sector. While they would also contribute $84 million derived through leases, station sponsorship and advertising, no reference is made to the related loss of opportunity or real revenue that the T.T.C. would incur. Significant, and as yet undetermined benefits would flow to the investors through capital cost allowances and possible other tax opportunities. As developers, the investors would have to pay the density charges but in effect would be paying them to themselves, merely flowed through the municipal collector. No attempt was made to evaluate the benefit that would accrue to the investors as a result of escalated property values because in all likelihood, at least some of these benefits would occur in any case if the subway line were built.

So in return for a real investment of 10% of the total project costs, the investors would receive a guaranteed rate of return of roughly 30% under Case C and a possible return of over 35% under Case B. Presuming that a legal basis could be established for the annual levy and density charges, the annual levy on the existing development and the one time charge on the unused density rights up to the existing Official Plan could be imposed without further municipal planning approvals being required. No real risk, therefore, is being incurred for the first two charges as it is expected that development would certainly, over the next 50 years, absorb that density. If no increases in densities were permitted and only those first two revenues were realized, a return of approximately 16% would be guaranteed. As a basis of comparison, typical rates of return in the development industry range from 15%-20% on an individual project basis. The real money starts to flow on densities over the existing Official Plan and captured by the third density charge.

It is suggested that a projected 35% rate of return juxtaposed against the risk to the private sector would be considered to be excessive. It is also suggested that a value would have to be assigned to the benefits being accrued through

tax opportunities and would have to be factored into the profit picture. On the other hand the public sector would be putting up the major share of the capital cost of the project and incurring all the operational risk of the Sheppard Subway line.

If Metropolitan Toronto Council were to pursue a public-private partnership, they would also want to consider the full benefits that would flow to the public sector, beyond the construction of the subway. A full benefit/cost analysis would need to be conducted.

Finally, on the issue of exclusive access to municipal own-source revenues, it is suggested that the municipal sector protect and preserve their few provincially bestowed birth-rights. Committing density revenues on an exclusive or partial basis into the future would be tantamount to handing over the property taxes generated in a part of the municipality. It is suggested that returns to investors should be made on some other basis.

6.0 CONCLUSIONS AND RECOMMENDATIONS

6.1 Conclusions

From the outset the representatives of the Solutions Through Partnership group had made the point that their primary interest was in seeing the Sheppard Subway built. They also indicated that if the culmination of their efforts resulted in the Province and Metro making a commitment to undertake the project alone, that they would not be disappointed. They had made it clear that their proposal had many unresolved areas and presented many opportunities for negotiation. They had in fact indicated in a media interview that they would be amenable to a total rewrite of their proposal if it was required.

In its current form, the Solutions Through Partnership proposal is not acceptable for the reasons stated in the body of the report. It is recognized as being a legitimate business proposition, one that most likely involved a great deal of effort and expense to assemble. It may represent an opening position from which to begin negotiations and as such, the extremes in the rate of return were probably never expected to be realized. Notwithstanding that there is currently no basis in law for the density charges and no commitment by the local municipality to move towards the suggested densities, this proposal represents the type of creativity and thought that may very well provide the solutions to future infrastructure financing problems.

As the public sector, we can continue to attempt to finance all public requirements in the conventional way. Where that depends on the infusion of considerable provincial monies, we may find that they continue to influence, if not dictate, the municipal agenda. There will be more Sheppard Subways -- more situations in which the Province does not share the goals of Metro Toronto. The private sector has indicated that it is willing to participate but it must be recognized that their assistance comes with a price.

In the current climate of uncertainty, there will be no simple solutions to financing the Sheppard Subway line. The answer may lie in a public-private venture, in a solely public venture, or in a combination of the two. It may be necessary to proceed without a guaranteed commitment from the Province of Ontario or in fact in the knowledge that there will be no commitment. It is clear, however, that the longer the solution takes, the greater the escalation of the cost of building the line.

6.2 Recommendations

At this point, no one solution has emerged that offers a clear advantage over another. There is every indication that the private sector has the interest to continue to pursue a solution. There are also purely public options including those discussed in Section 2.2 to explore. In an effort to move toward a final solution, it is suggested that both public and private options be explored simultaneously.

It is, therefore, recommended that Metropolitan Toronto Council:

1) endorse the "First Principles" as stated in this report to be used in the evaluation of future public-private partnership proposals for funding capital infrastructure in Metropolitan Toronto.

2) conduct a general call for proposals from the private sector that would propose concepts of public-private solutions to finance the construction of the Sheppard Subway Line;

3) indicate to Solutions Through Partnership that its proposal cannot be accepted as it has been presented and that a revised proposal be submitted in response to the public call for concept proposals; and

4) direct the Task Force on Financing Infrastructure Capital Expenditures to develop a number of concept options, that may or may not include a private sector component, for financing the Sheppard Subway and that these concepts be presented to the Management Committee by the end of June 1990 for consideration.

It is suggested that the Task Force should take a creative approach to the development of these options and that they not be restricted to solutions that have a basis in current legislation. It should also explore options that include a role for North York and possibly other area municipalities.

In terms of an appropriate strategy, it may be more expeditious for Metro to develop a number of financing options that make a variety of assumptions about the Province's commitment and then to present them to the Province rather than to wait for the Province to make a definitive statement about their participation. Taking a proactive role on this particular issue may resolve the current impass.